



NORTH CAROLINA CREDIT UNION LEAGUE

Committed to helping credit unions succeed

323 W. Jones St. Ste 601

Raleigh, NC 27603

800-822-8859

www.ncleague.org

February 1, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1404, Proposed Rule for Debit Interchange Fees and Routing

Dear Secretary Johnson:

On behalf of the North Carolina Credit Union League (League) and the state's 93 credit unions that we represent, thank you for the opportunity to comment on the Federal Reserve Board's (Board) proposed rules on the implementation of Section 1075 of the Dodd-Frank Wall Street Reform Act (Act).

The League acknowledges the daunting nature of the Board's task in writing rules to govern a system as complex as the card payment system. In short, the League believes that the Board's proposal, in part because of the aforementioned complexity and because of lack of adequate time, fails to properly implement the Act as intended by Congress.

The League finds there to be two primary flaws in the proposed rules – (1) lack of enforcement to ensure the establishment and maintenance of a two-tier network for exempt institutions and (2) inadequate consideration of the true cost associated with debit programs when establishing the interchange rate for those issuers above \$10 billion in assets and those below \$10 billion in assets.

Lack of Enforcement for Exempt Institutions

The Act provides an exemption from the Board established interchange rate for issuers under \$10 billion in assets (small issuers) and provides the Board with the authority to "prescribe regulations...to prevent circumvention or evasion" of the Act. We believe when considered together, this demonstrates that Congress provided the Board with adequate authority to ensure the establishment of a functional two-tier system – one for exempt and one for non-exempt institutions. Not only does the Act provide the necessary authority in our view, but a review of the discussion of the Interchange Amendment prior to passage and subsequent comments by members of Congress also provides a clear picture of Congressional intent.

Congress intended to protect the ability of small issuers to continue to recoup the costs associated with offering debit cards through the exemption. The significance of this point cannot be overstated since the per-transaction cost for small issuers is much higher than it is for the largest issuers. The inability or unwillingness of the Board to write rules that will provide for the creation of a two-tier system to protect exempt issuers is a clear disregard for Congressional intent and will



AMERICA'S
CREDIT UNIONS™
Where people are worth more than money.™

only result in small issuers, which includes all but a handful of credit unions, being forced to increase account fees to cover the cost of doing business.

We urge the Board to use the rule making authority provided in the Act to establish a functional two-tier system for exempt institutions that recognizes the difference in cost structure for large and small issuers and requires all networks to maintain such a system.

Inadequate Consideration of True Costs of Transactions

The Board's effort to establish the interchange rate for issuers over \$10 billion in assets fails to appropriately consider the true cost of debit transactions. The impact is significant not only for the large issuers to which the rate is specifically applied, but also to the small issuers as market forces are likely to drive the interchange rate on all transactions as close to this base rate as possible.

The 12 cent cap in the proposed rule is far too low. The Board excludes a number of reasonable costs in part because of its view of fixed cost in the rate setting process. For example, in discussing the per-transaction cost calculation used to arrive at the 12 cent rate the Board says, the "measure of per-transaction cost does not consider costs that are shared with other products of an issuer, such as common fixed or overhead costs, which would still be incurred in the absence of debit card transactions." This statement seems to contradict an earlier observation from the Board on costs associated with fielding complaints and inquiries from customers on debit transactions – "Other costs associated with a particular debit transaction might also include costs associated with providing customer service to cardholders for particular transactions, such as dealing with cardholder inquiries and complaints about a transaction."

On the one hand, the Board seems to recognize that the staff and infrastructure associated with fielding customer complaints are actual costs associated with a debit transaction while at the same time categorizing the staff and infrastructure as "fixed costs" that cannot be considered.

Another, perhaps more explicit, example of the Board neglecting to include the true costs of a debit transaction is the absence of fraud prevention and data security costs. The Board acknowledges this absence in its calculation of the 12 cent rate, "The Board requests comment on how to implement an adjustment to the interchange fees for fraud-prevention costs."

Not only are we concerned with the specific costs that the Board has chosen to disregard, we are also concerned with the source of that data. The Board did not survey issuers less than \$10 billion in assets. This failure to consider the costs of small issuers seems like a glaring oversight on behalf of the Board, given the certainty that the Board established rate for large issuers will ultimately impact those under \$10 billion as well.


We appreciate that the vague statutory language related to costs to consider and aggressive effective date in the Act have created significant challenges for the Board in developing the rate for large issuers. However, we urge the Board to reconsider its view of fixed costs such as those mentioned above, to complete its analysis of the related fraud prevention and data security costs, and to survey small issuers before issuing a final rule. A fair consideration of the true cost is essential for the Board to set an appropriate rate or formula.

Conclusion

We recognize that we have not commented directly on several of the specific areas where the Board was requesting feedback. Our lack of comment on some of these specific items is due in large part to our view that the proposal itself is fundamentally flawed. The proposal, perhaps because of the vague language in the Act, turns the payment card system on its head when Congress seems to have intended the Board to simply re-balance the system – lowering costs for merchants while protecting small issuers.

On behalf of North Carolina credit unions we ask the Board to reconsider the proposed rule with an eye toward ensuring the creation of a functional two-tier system and establishing an interchange rate or formula based on the true cost per transaction considering the cost of all issuers, regardless of size. Failure to address these concerns will only result in a drastic increase in the cost of service for North Carolina's 3.1 million credit union members. This is an outcome we find unacceptable and clearly at odds with Congressional intent.

Respectfully,



John Radebaugh
President